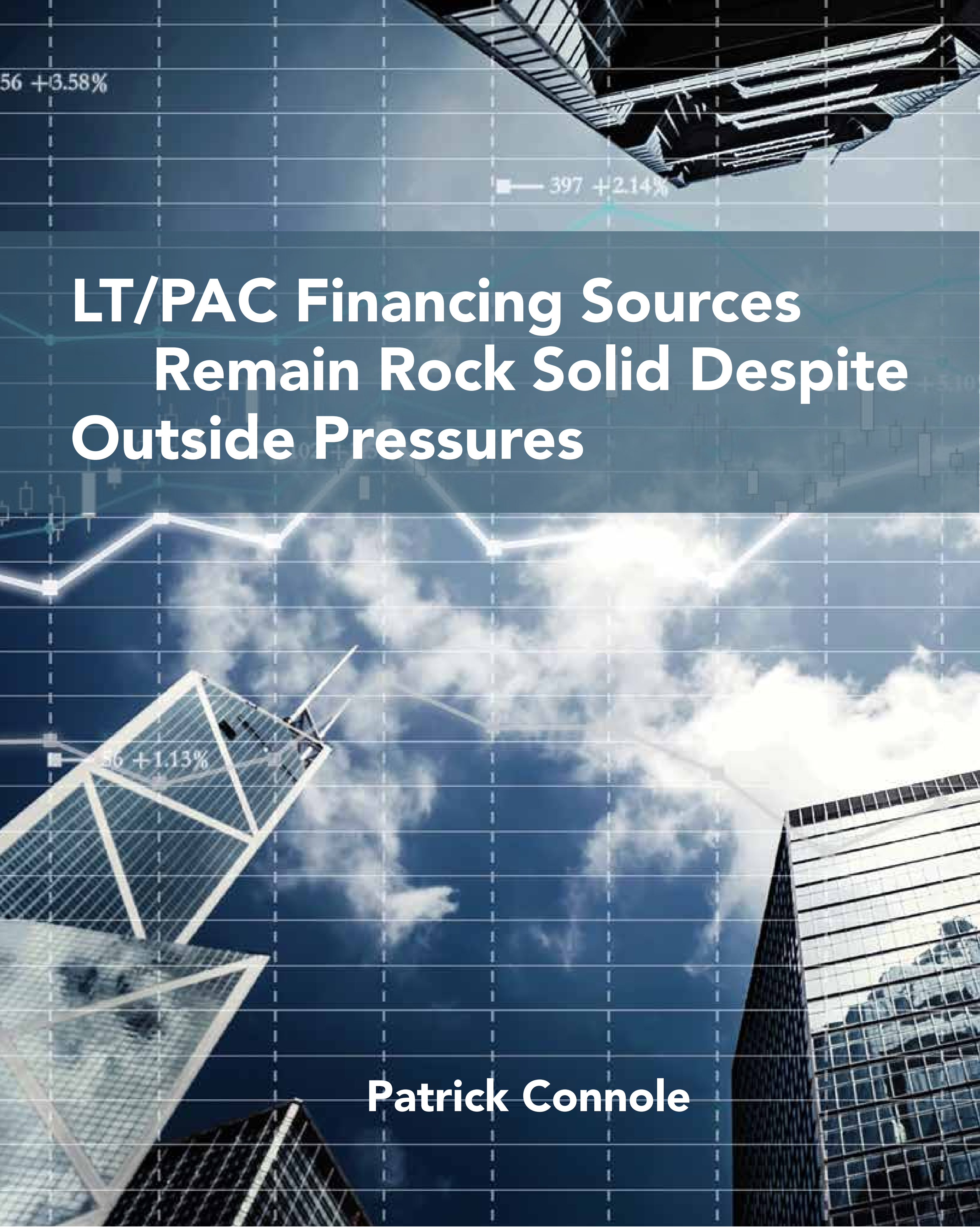

LT/PAC Financing Sources Remain Rock Solid Despite Outside Pressures

Patrick Connole

Concerns over labor and reimbursement eclipsed by accessible capital.

Even though margins are extremely tight and occupancy levels below optimal for many operators in the skilled nursing sector of the long term and post-acute care (LT/PAC) profession, financing programs and capital markets catering to the broader LT/PAC and seniors housing market are robust, according to experts in the field.

Kris Lowes, director, Evans Senior Investments in Chicago, tells *Provider* the lending market appears to be very healthy, with financing for new development still available for projects, albeit from different lenders than the past few years.

"New development is still preferred over rebuilds/remodels as older communities tend to have structural issues like lack of common space, lack of one- and two-bedroom units, hallway showers, etc., that prevent cost-effective remodels," he says. "We continue to see more and more community banks trying to grow their seniors housing lending platform, even at this stage in the cycle."

Echoing those sentiments, Erik Howard, managing director, real estate finance, for Capital Funding Group (CFG) in Baltimore, says the industry is cautiously optimistic on a number of fronts.

"Clearly, the strong economy helps to further bolster both state and local economies and state budgets, which helps to provide stability to Medicaid reimbursement," he says. "And, then again, with the strong national economy as well, that always provides a healthy backdrop for Medicare reimbursement."

REITs STAY ACTIVE AT A DIFFERENT PACE

Howard says real estate investment trusts, or REITs, continue to be active, albeit not as much so as they were from 2015 to 2017. "We've seen them refocus their attention on both their tenants and markets, and there have been some divestitures from a lot of the REITs of noncore assets or nonstrategic tenants or partnerships," he says.

Additionally, the REITs that may have been overweighted in one type of asset class are looking to expand into other parts of the continuum of care. This could be for diversification reasons.

This trend may come in the form of a REIT that is heavily invested in skilled nursing facilities (SNFs) branching into assisted living as well, or if holding a large portfolio of medical office building investments the REIT may diversify into other parts of the health care continuum, like long term care, Howard says. "I think reevaluating growth strategies has occurred here over the past 12 to 24 months, and generally that should be a positive for the REITs and growth for the next five years."

MACRO LEVEL OFFERS SOME CHALLENGES

Lowes says that if one takes a broader, or more macro examination of the state of the skilled nursing and assisted living market segments it is actually a nonreimbursement/occupancy problem that stands out, pointing to the labor issue as the most pressing dilemma the profession needs to grapple with.

"As the unemployment rate in some markets is below 3 percent, the competition for employees is often more difficult than for residents," Lowes says. "The amount of communities relying on agency staffing and overtime pay is at an all-time high, not only hurting operating profitability but also workplace culture due to staffing turnover."

Overdevelopment of buildings in certain markets has also contributed to this labor shortage, as much of the new building stock has been built in affluent suburban communities with limited access to public transportation, he adds.

Howard

'SILENT KILLER' INCREASINGLY STYMIES SNFs

Another form of bogeyman lurking in the sector is managed care, which Lowes calls "a silent killer" for SNFs as traditional Medicare Part A residents are replaced by managed care residents at lower reimbursement rates.

He thinks managed care will continue to drive the SNF space to a "winner-take-all" environment, with facilities that can demonstrate consistent quality metric data receiving the lion's share of the PAC payer mix.

For Howard, even though there has been some talk of different types of reimbursement changes to Medicare, generally, those have been viewed as in the right direction and potentially a positive for the industry.

"In terms of the economic impact to our industry, again everything seems to be moving in the right direction. We continue to talk about the baby boomers and have for a very long time, but we do think that that will continue to provide a support for the industry as aging Americans will continue to need rehabilitation services as well as long term care as they get older," he says.

MERGERS MAKE FOR GOOD BUSINESS

Pulling back to the deal-making side of the business, Howard sees straight acquisitions and mergers and acquisitions activity continuing to be a strong suit heading into 2019. "We have continued to provide a large amount of bridge to HUD [Housing and Urban Development] financing through our balance sheet. We will probably close nearly $400 million this year in bridge-to-HUD loans, and an additional $600 million in HUD refinancings. Rising rates have really put an emphasis on trying to find a long term fixed-rate solution for debt," he says.

This means many CFG clients have continued to gravitate toward the HUD refinancing program, which has generally been good, Howard adds.

FINANCING OPTIONS REMAIN FAMILIAR

The types of financing operators and investors in the LT/PAC and seniors housing space have not changed much in the past three to five years, he says.

"We think we will continue to see an increase in construction financing as some of the older assets really run their course in terms of their useful life," Howard says.

"We are starting to see more replacement facilities kind of come to fruition, which is fantastic for the industry and the resident alike as the needs and wants are changing, in particular again for those baby boomers."

Lowes says another important influence on the sector in recent times has been the much-discussed reorganization of some very large companies operating in the LT/PAC setting, leaving room for more than a fair share of mergers, corporate restructurings, and spin-offs.

"Although it appears a bit like musical chairs, it shows that the major players are becoming more focused on specific asset

types and unwinding relationships with some large operators," he says. "This trend will bode well for the health of the acquisition market in future years as these buyers return to the market with a renewed focus on growing their platform."

This shift has also allowed smaller, regional buyers the opportunity to step into the acquisition market in a more competitive way. "We believe the acquisitions market will continue to maintain an active pace over the next 12 months due to the availability of capital still present in our space," Lowes says.

And with this trend even more new buyers and operators will continue to emerge on a weekly basis looking to acquire seniors housing assets. "The industry is still very much in balance for both buyers and sellers today, and we expect that trend to continue. The industry appears very healthy over the near term," he says.

POLITICS AND OTHER PLAYERS

Another factor to weigh on any market sector is politics and policies in Washington, D.C. Howard says with the Trump administration, it is all about fewer regulations and streamlining processes, which is "good for business in any program."

As for the more direct impact the policymakers have on individual departments of the government, Howard says CFG has seen no major changes to the HUD financing platform. The company continues to work with the profession in its partnership with HUD to develop best practices and to make the program as efficient as possible and work for lenders and borrowers and HUD alike, he says. ■